RESEARCH HIGHLIGHT

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ESTIMATES OF THE PRIVATE AND SOCIETAL COSTS AND BENEFITS OF HOMEOWNERSHIP IN SELECTED CANADIAN CITIES

INTRODUCTION

The majority of Canadians become homeowners at some point in their lives and homeownership is associated with a number of potential private and societal costs and benefits. Private costs and benefits refer to those accrued to individuals as a consequence of owning a home. The societal costs and benefits of homeownership refer to those borne by society as a whole. This study aims to determine the costs and benefits of homeownership from both categories by testing a series of hypotheses. In each case, conclusions are drawn on the basis of an analysis of both statistical data (when available) and estimates (in the absence of hard data) in order to accept or reject each individual hypothesis. Information was gathered through a review of existing literature and the analysis of a variety of Statistics Canada data sets.

METHODOLOGY

The study uses the net present value method, over a 50-year time span, to determine the private costs and benefits of homeownership. This approach allows the researchers to compare, on the same present-value basis, the various private costs and benefits that are accrued at different times over the course of a lifetime of homeownership. The assessment of private cost and benefits focuses on six major Canadian cities: Vancouver, Calgary, Winnipeg, Toronto, Montréal and Halifax.

Statistical data on the societal costs and benefits of homeownership is often unavailable. In response, the authors draw on information presented in other studies to establish whether a particular societal cost or benefit in fact exists and, if possible, indicate the size of the associated effect. Often times, it is necessary to develop proxy indicators in order to determine that homeownership has an impact on certain hypothesized variables. The assessment of societal costs and benefits is for Canada as a whole rather than for individual cities because of the nature of this category of costs and benefits.

LIMITATIONS

Problems with data availability represent the most significant limitation of this study. In many cases, the authors are not able to quantify or draw definitive conclusions about the net costs or benefits of homeownership. As a result, some estimates and conclusions are based on either indicators or assumptions which necessarily introduce a margin of error.

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PRIVATE COSTS AND BENEFITS OF HOMEOWNERSHIP

The following sections summarize the key findings relating to the private costs and benefits of homeownership.

Homeownership may lead to higher expenditures on the dwelling, including mortgage payments, property taxes and expenditures on utilities, insurance, maintenance and repairs

The authors accept this hypothesis. While operating expenses are lower than the cost of renting in each city, the combined cost of mortgage payments and operating expenses is higher than the cost of renting. The study finds that the present value of mortgage costs for an average townhouse in each of Canada's major cities over 50 years of ownership are highest in Vancouver and Toronto, at $146,150 and $145,170 respectively, and lowest in Winnipeg, at $60,264. This cost disparity reflects wide differences in house prices between cities. However, the present value of homeowner operating costs in Winnipeg is the highest of the study cities at $131,113, due to high property tax rates, insurance costs and severe winters, which drive up utility expenditures. In contrast, operating costs in Vancouver are the lowest of the major Canadian urban areas at $75,407; little more than half of those in Winnipeg. The present value of combined mortgage and operating costs in Toronto is $275,330, the highest in Canada, and $169,930 in Montréal, the lowest in the country.

Homeownership may increase the transactions costs of moving

The authors accept this hypothesis. Transaction costs of moving include legal, survey, inspection and appraisal fees, which the authors assume do not vary significantly between cities. However, other transaction costs, such as land transfer taxes and real estate commissions, are set as percentages of home prices. Consequently, these costs differ greatly between cities. The authors conclude that these costs amount to between four per cent and nine per cent of the cost of homeownership, depending on location. To estimate the transaction costs of moving, the authors develop a scenario in which a household purchases and sells two different homes in the same city over the course of 50 years of homeownership. Under this scenario, the present value of the transactions costs of moving are lowest in Winnipeg, at $8,040, and highest in Vancouver and Toronto, at $16,526 and $15,410, respectively. Overall, in terms of moving transaction costs, fewer household moves will amount to greater cost savings.

Homeownership may confer tax advantages

The authors determine that the tax benefits of homeownership in Canada are questionable. The Home Buyers' Plan, which allows first-time homeowners to withdraw funds from their RRSPs without tax penalties for the purposes of purchasing a home, does confer a tax advantage. However, the additional taxes homeowners must pay (for example, property taxes and land transfer taxes) and the tax deductions landlords are eligible for (including rental loss and capital cost depreciation allowances) largely offset each other when considering the tax advantages of homeownership relative to renting in Canada. In other countries, notably the United States, homeowners are able to deduct mortgage interest from their income for tax purposes, which represents a major tax benefit of homeownership. However, this deduction is not permitted in Canada.

Homeownership may lead to the accumulation of wealth through mortgage amortization and home price appreciation

The authors find that homeownership can provide a substantial benefit in terms of household accumulation of wealth. However, the size of this benefit is extremely sensitive to location. For example, homeowners in Winnipeg stand to benefit far less than homeowners in Vancouver and Toronto in terms of accumulating wealth through homeownership. The authors estimate that the present value of a household's net housing wealth accumulated through home price appreciation over 50 years of homeownership in Winnipeg is $5,857. While in Vancouver and Toronto, home price appreciation over 50 years of homeownership will yield $59,853 and $36,945, respectively, of net housing wealth in present value terms. This discrepancy between cities reflects wide differences in local housing price inflation rates. In comparison, households who rent their homes will accumulate no housing wealth through home price appreciation.

Homeownership may "lock in" wealth

This hypothesis refers to financial restrictions placed on households as a result of having the majority of its net worth "locked in" as home equity. The authors reject this hypothesis. Low down payment financing options available across Canada make homeownership possible with a relatively small investment of wealth. Furthermore, the wealth that a household has in the form of its home equity at a later age in life is largely created as a result of its decision to take on mortgage debt and become a homeowner. As well, financial instruments have been developed that permit homeowners to easily borrow against their home equity in order to diversify their portfolio or for consumer spending purposes.

Homeownership, through housing over-investment, may constrain portfolio choice and hence assume more investment risk

The authors accept this hypothesis. Homeowners are subject to investment risk because house prices fluctuate, but the cost associated with this risk tends to be very low. Moreover, a home, unlike other investment assets, also provides the owner with consumption as well as investment benefits. The consumption benefits persist independently of rising or falling house prices. Also, if a homeowner is forced to move during a period of low house prices, s/he may have the option of renting the dwelling while they wait until prices rise again before selling.

Homeownership may provide a source of financial support in the case of income stream disruption

The authors accept this hypothesis. Home equity is important for a person applying for a loan to ride out an income or expenditure shock. The authors estimate the present value of this benefit to be $3,500. This estimate was developed by assessing the difference between the interest charges on the mean credit card debt of Canadians in 1999 and the potential interest charges if the same debt was secured by a second mortgage.

Homeownership may promote personal and family well-being, including happier and healthier family members and improved child outcomes

The authors accept this hypothesis on the basis of evidence showing the positive effect of homeownership on child outcomes. Using the National Longitudinal Survey of Children and Youth, the authors find that children of homeowners tend to score better on both mathematics and reading tests than the children of renters. The mean mathematics and reading scores of children of homeowners with a household annual income of less than $60,000 are four per cent higher and three per cent higher, respectively, than the children of renters of the same income group. As a measure of behaviour, the data also shows that on average, the children of homeowners with a household income of less than $60,000 commit 18 per cent fewer property offences than the children of renters in the same income group.

SOCIETAL COSTS AND BENEFITS

Homeownership has impacts that extend beyond the individual household to affect society in general. However, determining the magnitude and direction of these societal effects is often difficult due to a lack of data and effective valuation procedures. As a result, the authors are limited to qualitatively discussing the existence and impact of these costs and benefits rather than estimating a market value associated with their effect.

The following sections outline the key findings of this discussion.

Homeownership may increase urban sprawl

The authors reject this hypothesis. In recent years, a range of homeownership options have become increasingly popular in the housing market in many large cities. In the past, the overwhelming majority of homes available for purchase were of the low-density, single-detached variety characteristic of sprawling suburban areas. In 1948, 81 per cent of housing starts were single-detached units. More recently, prospective homeowners have the option of purchasing a townhome or condominium in one of many medium- and high-density housing developments in Canadian cities. In 2004, only 55 per cent of housing starts in Canada were single-detached. While a desire for homeownership may have led to increased urban sprawl in the past, higher-density housing tenure options available today suggest homeownership is no longer a fundamental source of sprawl.

Homeownership may increase commuting needs, energy consumption and pollution

The authors reject this hypothesis. Because homeownership is no longer synonymous with living in a single-detached home in a low-density subdivision, homeownership is not necessarily responsible for increased commuting needs, energy consumption and pollution associated with sprawl. As well, more Canadians tend to become homeowners after the period during which they endure their longest commute distances. Of working age Canadians, those aged 35–44 have the longest median commutes (eight km) while the homeownership rate for this age group is 67 per cent. For those aged 45–54 and 55–64, homeownership rates rise to 75 per cent and 77 per cent, respectively, while median commute distances decline to 7.6 km and 7 km, respectively. In terms of household energy consumption, homeowners have a greater economic incentive to minimize energy use than renters to the extent that utilities are included in the rent. Homeowners pay for their individual energy use while, in many cases, utility costs are included in the rent paid by tenants. Also, the cost of energy is tax deductible for landlords but is not for homeowners. As a result, increased commuting, energy consumption and pollution cannot be directly attributed to homeownership.

Homeownership may lead to increased class inequality, including racial segregation

The authors note that low-income people in Canada are relatively unsegregated in comparison to those in other countries so little class inequality can be explained by homeownership. However, the authors tentatively accept that a cost of homeownership is its potential contribution to racial segregation. The authors cite recent studies which find evidence of ethnic and racial enclaves in Canadian cities. Empirical evidence is also used to show that homeownership is in part linked to segregation. For example, Canadian homeowners with an annual household income between $40,000 and $60,000 are 14 per cent less likely to have ethnically and linguistically diverse friends than renters of the same income group. The authors also use a similar indicator to surmise that property value protection motives among homeowners can lead to not-in-my-backyard (NIMBY) behaviour that may directly or indirectly discriminate against ethnic and racial minority groups.

Homeownership may reduce investment in other economic sectors, therefore decreasing economic and job growth

The authors reject this hypothesis. Using data from the 1999 Statistics Canada Survey of Financial Security, the authors found that rather than reducing investment, homeownership tends to greatly increase household saving and investment in non-housing assets. Homeownership has a large positive impact on a household's tendency to save money in RRSPs, invest in real estate outside the principal residence and purchase non-RRSP financial assets and equities. This impact is particularly great for those in the lowest income class. For instance, Canadian homeowners aged 45 to 64 with an annual income of less than $20,000 tend to save about $36,000 more in RRSPs, and $33,000 more in non-RRSP financial assets, than renters in the same age and income class.

Homeownership may encourage environmentally conscious beliefs, including recycling and a well-maintained yard

Homeownership has a positive impact on recycling, especially for low-income households, which is a positive societal outcome. However, homeownership is also associated with increased pesticide use, particularly by high-income households. Pesticide use creates environmental and health hazards so an increase in their application comes at a societal cost. The authors cannot accurately price these offsetting activities so determining the net impact, positive or negative, is impossible. Since there could be a net negative societal impact, the authors reject the combined hypothesis that homeownership encourages environmentally conscious beliefs.

Homeownership may increase civic involvement, including voting and volunteering

The authors accept this hypothesis. Survey data demonstrate that homeownership is associated with increased membership in civic groups, municipal, provincial and federal voting, volunteer work and charitable donations. This effect is especially large for high-income homeowners. In terms of voting behaviour, homeowners aged 35 to 54 with an annual income greater than $60,000 are 21 per cent more likely to vote in municipal elections and 13 per cent more likely to vote provincially or federally relative to renters in the same age and income group. Homeowners in this high-income class are also nine per cent more likely to volunteer with local organizations and seven per cent more likely to donate to charity in comparison to renters. The authors caution that these effects may be a consequence of homeowners' propensity to stay longer in their neighbourhoods than renters and hence develop stronger local ties.

Homeownership may reduce the duration of unemployment, thereby increasing income and decreasing welfare receipt

The authors reject this hypothesis. In fact, the authors find some support for the proposition that the duration of unemployment for homeowners is longer than that of renters. For example, eight months after leaving a job, homeowners with a household income of $20,000 to $40,000 are seven per cent more likely to still be out of work relative to renters of the same income group. Similar, but smaller, percentages are found for other income classes. In the event of unemployment, the greater wealth of homeowners permits them to pursue a more prolonged job search. Also, the higher transaction costs of moving that homeowners face tend to limit their labour mobility, discouraging them from pursuing available jobs in other cities.

Homeownership may increase the health of occupants

There is mixed evidence of the impact of homeownership on the health of occupants, which leads the authors to reject this hypothesis. Data from the National Population Health Survey shows that homeowners with a household income greater than $20,000 tend to score worse than renters on the Body Mass Index (an indicator of being overweight). Further evidence suggests that lower-income households enjoy health benefits associated with homeownership, while no such benefit is apparent for higher-income households. Specifically, for the lowest income group, homeowners on average spend nearly one less night per year in hospital, are two per cent less likely to receive medical care at home and nearly one per cent less likely to suffer an injury at home than renters of the same income group. On the other hand, the health indicators of homeowners with a household income over $40,000 tend to be worse in comparison to renters of the same income class.

Homeownership, through increased residential permanence, may reduce academic and behavioural problems amongst children and youth

The authors accept this hypothesis. Homeownership is linked to improved mathematics and reading scores in young children of all income classes and for adolescents in lower-income groups. Using data from the National Longitudinal Survey of Children and Youth, the authors conclude that homeownership is associated with a mean improvement of five per cent on math scores and six per cent on reading scores for the children of homeowners. The mean improvement associated with homeownership is about two per cent on each score for adolescents. Lower high school dropout rates are also linked to homeownership. This effect is particularly strong for low-income households. Sixteen and seventeen year old children of homeowners with an annual household income of less than $20,000 are nearly 13 percent less likely to drop out of school than similarly aged children from rental households with the same income level.

CONCLUSIONS

Evidence presented in this report shows that, in terms of specific private costs, homeownership tends to encourage household wealth accumulation, provide a means of financial support to ride out sudden household financial difficulties, contribute to family well-being and improved child outcomes, lead to higher housing-related expenditures, increase the transaction costs of moving and increase households' investment and default risk. However, homeownership does not necessarily "lock in" household wealth and the tax advantages of homeownership are unclear.

The societal costs and benefits of homeownership are far more difficult to quantify. In the end, the authors were only able to determine the possible existence or absence of the effects described by the various hypotheses. The findings of this study show that homeownership tends to increase civic involvement, contribute to racial segregation and reduce academic and behavioural problems among children and adolescents. On the other hand, homeownership does not necessarily increase commuting needs and energy consumption, reduce household investment in other economic sectors, decrease the duration of household unemployment or improve the health of occupants. While the findings of this study are informative, they are at times limited by a lack of available data.

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Housing Research at CMHC

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